Vietnam: Loan and savings programme in rural areas

Ex post evaluation report

OECD sector	24030 - Financial institutions of the formal financial sector	
BMZ project ID	2000 66 316	
Project executing agency	Vietnam Bank for Agriculture and Rural Development (VBARD)	
Consultant	Not applicable	
Year of ex post evaluation	**2006**	
	Project appraisal (planned)	**Ex post evaluation (actual)**
Start of implementation	10/2002	10/2002
Period of implementation	24 months	7 months
Investment costs	No information available	No information available
Counterpart contribution	No information available	No information available
Financing, of which Financial Cooperation (FC) funds	EUR 2.6 million	EUR 2.6 million
Other institutions/donors involved	none	none
Performance (overall rating)	3	
• Significance / relevance (sub-rating)	3	
• Effectiveness (sub-rating)	3	
• Efficiency (sub-rating)	4	

Brief description, overall objective and project objectives with indicators

The overall objective of the project was to contribute to the economic development in rural areas and the development of the financial system. The project objective was to provide sustainable and efficient financial services to micro and small enterprises (including smallholders) in rural areas. For this purpose FC funds amounting to EUR 2.6 million were made available to the Vietnam Bank for Agriculture and Rural Development (VBARD). The programme region comprises five rural provinces in the north of Vietnam and in the immediate vicinity of the Red River.

Programme design / major deviations from the original programme planning and their main causes

VBARD, which was established in 1988, has existed since 1990 as a financial institution which is economically separate from the State Bank of Vietnam (SBV). VBARD is wholly owned by the state and is subject to direct supervision by the SBV. Since 1996 it has focused particularly on its work on the "development of the rural economy". In the rural areas VBARD is the main financial institution. It therefore also continues to serve as an important government instrument in the field of poverty reduction in the rural regions. We are of the opinion that political influence was most probably exerted (at least indirectly) on the lending process. In contrast to the other state commercial banks (SOCB), there are so far no actual indications or plans with regard to privatisation or partial privatisation of VBARD.

In recent years VBARD has received extensive technical support (including from the Asian Development Bank and the World Bank) and has actually been in a restructuring process since 2001. However, this restructuring process has not always been straightforward and consistent. In addition to improvements in the organisational and operational structure (e.g. prompt transfer of information between branches and the head office by online connections), the main very positive developments since the project appraisal are the physical separation of VBARD from the Bank for Social Policy (formerly Bank for the Poor) and the greater transparency in the publication of the annual financial statements. From the point of view of transparency, we consider it positive that for some five years VBARD has been consistently publishing annual financial statements on the basis of international accounting standards. Overall, the pace of reform seems to be gaining momentum owing to clear political requirements since 2004 and the opening-up of the banking sector expected to result from Vietnam's efforts to become a member of the WTO.

The Socialist Republic of Vietnam, represented by the Ministry of Finance, is the borrower of the FC funds totalling EUR 2.55 million. The FC funds were forwarded to VBARD by the Ministry of Finance as the project executing agency in the domestic currency with a term of 10 years and were used to set up a revolving credit fund of VND 39.7 billion (EUR 2.55 million at the time of disbursement). Thereafter, the funds were to flow back to the recipient or to remain with VBARD as a capital contribution. The refinancing rate for VBARD was to be positive in real terms and to be based on the market rates applicable for term deposits in the banking system. The sub-loans should be granted at market-based interest rates. Return flows to the bank from repayments of the sub-loans were to be used for a further lending. A maximum of five years was set as the term for the sub-loans and the maximum amount for sub-loans used for financing investment capital and working capital was fixed at VND 20 million. No redemption-free grace years were granted. The interest differential funds were accumlated in a counterpart fund account of the Ministry of Finance kept with VBARD and were to serve as cover for the exchange rate risk and to develop new savings products for rural customers. The exchange rate risk was borne by the Ministry of Finance, which we consider appropriate. Due to the strong depreciation of the VND vis-à-vis the Euro the interest differential funds have so far been used only to cover the exchange rate risk. According to information provided by the Ministry of Finance this practice will be maintained in the future as well. According to information by VBARD the Vietnamese government has so far not taken any decision as to whether the FC funds will be left with VBARD as equity capital after the end of the 10-year credit term.

At the time of the ex post evaluation, 16,827 loans with a total volume of VND 140.1 billion (approximately EUR 6.8 million) had been granted. The fund has thus revolved 3.5 times since the start of the project. Most of the loans had a maturity of up to one year and were granted to finance working capital. The average loan is for VND 8.3 million or EUR 404. The sectoral distribution of loans puts trade and services (approx. 40%) in the lead, followed by agriculture with a share of 26% (all other sectors: 34%). The loans are distributed relatively evenly across the five provinces. Around 43 % of the borrowers were women. The programme was implemented very swiflty. Already seven months after the readiness for disbursement all FC funds had been disbursed.

The loss in real value of the revolving fund is a problem. It is due to a fault in the programme design. As only the redemption payments flow back into to the fund, while the interest payments flow into the income statement of VBARD, compensation for inflation is not possible even if a repayment rate of 100% is assumed. To ensure that the real value of the credit fund is retained it would have been required to allocate additional counterpart funds and/or to assign part of the interest payments from sub-borrowers to VBARD. The loss in real value of the fund during the period of implementation corresponds largely with the rate of inflation (calculated on a local currency basis). On this basis it can be assumed that the actual loan repayment rate was relatively close to 100%. As part of the FC project, the cooperation between VABRD and the Women's Union ("retail lender") with regard to the granting of sub-loans proved very worthwhile.

The random checks of loan files and visits to the borrowers showed that the above-mentioned onlending and sub-borrower terms and conditions were observed. The on-site review of the books to check how the funds were used provided no indication of misuse of funds.

Key results of the impact analysis and performance rating

The objective of the project was to have VBARD provide sustainable and efficient financial services to micro and small enterprises (including smallholders) in rural areas.

In the year 2005 the following indicators were used to determine whether the programme objectives had been achieved: (a) gross loan portfolio of the revolving fund is more than or equal to EUR 2.6 million (real capital value); (b) share in the total loan portfolio of loans with interest and/or principal arrears of over 90 days is less than or equal to 5%; (c) share of restructured loans in the FC programme is less than or equal to 3 %; (d) average amount of loan is less than or equal to EUR 767; (e) new savings services are being identified and tested in pilot provinces.

At the time of the ex post evaluation, indicator (a) had not been met, as the VND had depreciated considerably vis-à-vis the euro (at the time of the ex post evaluation, real value of the fund: EUR 1.9 million). Even if the (more appropriate) indicator of the real value in VND is used, compared with the original fund volume of VND 39.7 billion there has been an inflation-induced loss in real value (real value compared with the time of project appraisal: VND 33.0 billion). This is, in particular, because, in accordance with the agreement, only repayments to the revolving fund are recorded and not interest payments. Even at very good repayment rates, inflation causes a fund structured in this manner to lose real value. The loss in real value of the fund during the period of implementation corresponds largely with the rate of inflation. According to information from VBARD, the indicators (b) and (c) were met, at 1.4 % and 0.2 % respectively. Taking account of the restrictions regarding the quality of the portfolio in the auditors certificates issued by PWC for the VBARD annual financial statement 2004 and the random samples taken by the evaluation mission at VBARD branches, the values do not, however, appear very informative. The level of the actual portfolio at risk cannot be determined as it is apparently VBARD practice in the FC project not to settle interest payments and repayments of the principal until the end of the loan term. The degree of achievement of indicator (d) is good given an average loan amount of EUR 404. Contrary to the original programme concept no counterpart funds were used to finance measures targeted at mobilising more savings. Therefore, indicator (e) is no longer relevant. Overall, we judge the programme objectives to have been achieved to a just sufficient degree.

By improving access to financial services, the programme aimed at making a contribution to the economic development in rural areas and to the development of the financial system (overall objective). The overall objective was to be deemed to have been reached if (a) enterprises' assets and the income of households had increased in relative terms in relation to the control group outside the programme region and the access to savings services had been expanded. The indicator was adjusted in accordance with the progress review 12/2005 in that a "before" and "after" comparison was to be made rather than a comparison with a control group.

At the time of the ex post evaluation there was no empirical study on the income effects of the FC project on the target group. Subsequent collection of data would be time-consuming and expensive as well as problematic in terms of methodology and because of the lack of initial data. It therefore appeared to be more appropriate to select easily collected proxi-indicators, such as the poverty rate in the programme regions, as the provincial governments have these figures for individual districts and municipalities available. In the programme province of Thanh Hoa visited as part of the ex post evaluation, the FC project was carried out in 7 districts in 32 municipalities. On average, the poverty rate in all municipalities has more than halved, although the official poverty line in rural areas was raised between 1998 and 2006 from an income of VND 70,000 per person per month to VND 200,000. According to information provided by MOLISA and the provincial government, no pro-poor loan programme other than the FC project was carried out in the programme region. We therefore assess the real economic impact of the project (income increases) as good.

Overall, the FC project has made a substantial contribution to improving the provision of financial services in the programme region. Access by the target groups to the formal financial sector has been improved. It has to be mentioned, however, that the measures to improve the mobilisation of savings by VBARD were not implemented because the counterpart funds originally earmarked for this purpose were instead used by the Ministry of Finance to hedge the exchange rate risk. The (statistically not representative) survey of the target groups showed that only some of the borrowers had first-time access to VBARD or other formal financial institutions. The extent to which, in the context of its normal credit business, VBARD will provide a further substantial service to target groups with first-time VBARD loans and without real collateral is open to question. We also evaluate the credit technology in normal use at VBARD as suboptimal for the target group in the FC project. However, we consider positive the fact that the target group (in particular the part of it which previously had no access to the financial sector) was introduced to the formal financial sector and able to gain positive experience of bank financing. In summary, we judge the achievement of the overall objective to be sufficient.

The programme region comprises the five rural provinces of Nghe An, Thanh Hoa, Thai Binh, Ninh Binh and Bac Ninh in the north of Vietnam in the immediate vicinity of the Red River. The target group comprised micro and small enterprises (including smallholders) in rural and semi-urban areas in the programme region and their integration into the local product markets. It can be assumed that the group targeted by the project was largely reached. This is indicated by the relatively low average loan, the high number of loans granted and the results of the surveys of borrowers conducted during the ex post evaluation.

The project is fundamentally in line with the current development policy objectives and priorities of the federal government in the financial sector (sector concept financial system development from 2003) and in relation to the poverty reduction objectives (MDG). It is also in keeping with the economic and social policy objectives and priorities of the government in Vietnam. Against the background of the long-known challenges of carrying out a fundamental restructuring of the state banks with the aim of improving efficiency, increasing transparency and achieving as much depolitisation as possible, however, future projects with VBARD should be more firmly imbedded in the sectoral reform process. A large number of „small" projects that are not directly related to sector reforms otherwise run the risk of being counterproductive in terms of VBARD restructuring.

The fact that micro and small rural enterprises working on a family basis and outside of agricultural production have insufficient capital or have only inadequate access to finance is still a major restrictive factor in terms of increasing productivity, generating additional income and diversifying sources of income. In the five programme provinces, the FC project made an important perceptible contribution to giving the target group better access to financial services in the formal banking sector and hence to reducing the restrictive factor. This was achieved, in particular, through the cooperation of VBARD with the Women's Union in handing out loans to sub-borrowers. Our analyses show that the positive real economic effects on the target group anticipated in the project appraisal were achieved. At the time of the ex post evaluation a total of 16,827 loans for an average of EUR 404 each (approximately VND 8.3 million) had been granted. Most of the loans had a maturity of up to one year and were granted to finance working capital in the trade and service sectors. 43 % of the borrowers were women. In this way, the project made an important contribution to the economic development and to alleviating poverty in the programme provinces. The expected impacts on the development of the financial sector (gaining new customer groups for VBARD and developing savings products, demonstration effects for other financial institutions and state pro-poor lending programmes) occurred only to a very limited extent. This is primarily due to the ongoing institutional weaknesses of VBARD, the high political resistance, particularly at the local level, to market-oriented interest rates for poor sections of the rural population and the fact that the savings component of the programme was not implemented.

The risks to the achievement of the objectives identified in the project appraisal occurred in that the necessary reforms of SOCB and, particularly, VBARD were implemented more slowly and less consistently than anticipated. This constituted the main weaknesses of the project. However, no foreseeable resultant sustainability risks can be ascertained at present.

In a summarised evaluation of the above mentioned aspects we rate the overall developmental effectiveness of the programme as follows:

Effectiveness

The objective of the project was to provide sustainable and efficient financial services to micro and small enterprises (including smallholders) in rural areas. Measured in terms of the objective indicators, the programme objective has only been partly met. A positive assessment is made of the broad impact of the programme, with more than 17,000 loans, a relatively low average loan and the high turnaround rate of the revolving fund. The quality of the FC portfolio, which is probably only just sufficient, can be criticised. On the other hand, we judge the high repayment rate as a very positive aspect. This is also due to the involvement of the Women's Union in the lending process. Ultimate loan losses are relatively rare. A problematic aspect continues to be the loss in real value of the revolving credit fund, which is due to a fault in the programme design: Only repayments of capital are credited to the revolving fund but interest payments are not. Actually, the loss in real value of the fund during the period of implementation calculated in local currency corresponds largely with the rate of inflation. The further institutional reforms of VBARD currently being carried out, the apparent increase in the pace of the reform and the generally correct and positive reform orientation are positive signs. We consider particularly positive the progress made by VBARD with regard to greater institutional independence since the programme appraisal. It can be assumed that the Vietnamese state will support the further reform process of VBARD through additionally required recapitalisation measures. Once VBARD has achieved economic independence, further subsidies can probably be stopped or made more transparent. The effectiveness of the project is thus sustained. Overall, we judge the project's effectiveness to be just satisfactory (**sub-rating: 3**).

<u>Relevance/significance</u>

The overall objective of the project was to contribute to the economic development in rural areas and the development of the financial system. Due to lack of data impacts on the real economy could not be verified. Given the generally positive economic development, the strongly increasing importance of the private small and micro business sector and the strong decline in the poverty rate in the programme province of Thanh Hoa, it is feasible to assume that the project will have positive effects on the real economy. We consider the impact on the financial sector to be limited. As the savings component of the project was not implemented no impacts were found in this field. However, the revolving use of the loan fund can be assumed – though with a continuously decreasing real value - to lead to a broad-based loan offer for the target groups. Still, the fundamental relevance of loan financing for small and micro enterprises is obvious. Thus, we classify the project's developmental relevance and significance as just sufficient (**sub-rating 3**).

<u>Efficiency</u>

Overall, the earnings situation and the capital endowment of VBARD is slightly insufficient. The same applies to the quality of the portfolio. The indicators of the achievement of the programme objective with regard to the FC portfolio quality have probably not been met. Despite the improvement in the technical opportunities afforded by a real-time management information system, the quality of the data on portfolio quality and loan risk is still poor. We consider the market-based design of the ultimate borrower rates positively. Overall, we judge production efficiency as slightly insufficient. With regard to allocation efficiency, it can be assumed that the rural households make clearly appropriate use of the loans. Overall, we rate the project's efficiency as slightly insufficient (**sub-rating: 4**).

In a summarised assessment of the above impacts and risks we rate the programme as having just sufficient developmental effectiveness **(overall evaluation: rating 3)**.

General conclusions and recommendations

When selecting indicators for the real economic impacts of projects in the financial sector, care must be taken to ensure that reasonable cost and effort is observed in their collection. Moreover, at the time of the project appraisal it is essential to determine the party responsible for any impact analyses which may be required. However, all known empirical methods for an impact analysis ("before and after", comparison with control groups) require a considerable amount of time and cost and generally lead only to very limited results. Therefore, the basic rule should be to give priority either to identifying existing and easily defined real economic indicators (e.g. official poverty rate, number of employees, share of SMSEs in GDP) or to selecting financial proxi-indicators to illustrate the real economic achievement of the objectives.

It makes little sense to link the real value retention of revolving loan funds in domestic currency to the euro or US dollar as exchange rate developments only rarely reflect inflation differences between the domestic and the foreign economy. By contrast, it is appropriate to take account of the rate of inflation in the partner country (plus any loan losses). The use of appropriate counterpart funds to retain the real value of the revolving fund should be formulated as a standard condition for financial sector projects (grant financing).

To ensure that revolving credit funds maintain their value in real terms sufficient inflows have to be provided to compensate for any loan losses or depreciations due to price increases. This may be achieved by using part of the interest payments made by the sub-borrowers and / or allocations from the counterpart resources fund. If in the event of FC loans the counterpart resources fund has to be used to hedge currency risks for the recipient or the project executing agency part of the sub-borrower interest payments and / or corresponding payments by the bank have to be earmarked accordingly.

In the case of known structural weaknesses at the project executing agency, such as in the case of VBARD, FC projects should be integrated more firmly into sector projects or at least closely coordinated with them. In so doing, verifiable progress in the restructuring of executing agencies should be taken into account as important conditions/requirements in FC projects.

Legend

Developmentally successful: Ratings 1 to 3	
Rating 1	Very high or high degree of developmental effectiveness
Rating 2	Satisfactory developmental effectiveness
Rating 3	Overall sufficient degree of developmental effectiveness
Developmental failures: Ratings 4 to 6	
Rating 4	Overall slightly insufficient degree of developmental effectiveness
Rating 5	Clearly insufficient degree of developmental effectiveness
Rating 6	The project is a total failure

Criteria for the Evaluation of Project Success

The evaluation of the "developmental effectiveness" of a project and its classification during the ex-post evaluation into one of the various levels of success described in more detail below concentrate on the following fundamental questions:

- Are the **project objectives** reached to a sufficient degree (aspect of project **effectiveness**)?
- Does the project generate sufficient significant **developmental effects** (project **relevance** and **significance** measured by the achievement of the overall development-policy objective defined beforehand and its effects in political, institutional, socio-economic and socio-cultural as well as ecological terms)?
- Are the **funds/expenses** that were and are being **employed/incurred** to reach the objectives appropriate and how can the project's microeconomic and macroeconomic impact be measured (aspect of **efficiency** of the project conception)?
- To the extent that undesired **(side) effects** occur, are these tolerable?

We do not treat **sustainability**, a key aspect to consider for project evaluation, as a separate category of evaluation but instead as a cross-cutting element of all four fundamental questions on project success. A project is sustainable if the project-executing agency and/or the target group are able to continue to use the project facilities that have been built for a period of time that is, overall, adequate in economic terms, or to carry on with the project activities on their own and generate positive results after the financial, organizational and/or technical support has come to an end.